



ASIC

Australian Securities & Investments Commission

The regulator's perspective on the regulation of SMSFs

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Introduction

Good morning and thank you very much for inviting me to speak today. I'm delighted to be at the Institute of Chartered Accountants Australia's (ICAA) national self-managed superannuation funds (SMSF) conference. Today I will be focusing on the recent work ASIC has undertaken in relation to SMSFs and our proposed work over the coming months.

In September last year, Deputy Chairman Peter Kell and I became jointly responsible for heading up ASIC's SMSF taskforce, so it's fair to say that I have a strong interest in all things SMSF.

The SMSF sector is growing rapidly and more Australians than ever before are either considering or operating an SMSF. Today, however, I'd like to focus on three key things:

- the critically important role of gatekeepers in the SMSF sector
- ASIC's focus on SMSFs and our review of the quality of advice provided to SMSF investors
- ASIC's consultation paper on additional disclosure and costs.

SMSFs and the critically important role of gatekeepers

SMSFs are the fastest growing sector of the superannuation industry.

ASIC's primary role in relation to SMSFs is to regulate the gatekeepers – the accountants, financial planners, SMSF auditors and providers of products and services to SMSFs. ASIC also regulates many (but not all) of the financial products that SMSFs commonly invest in. From that perspective, we are very keen to ensure that SMSF trustees are adequately equipped to make good investment decisions by being fully informed about the risks and returns.

We think that accountants and other gatekeepers have a critically important role to ensure that:

- at an individual level, only those investors for whom an SMSF is suitable go into the SMSF sector and, in doing so, they are fully informed
- at an aggregate level, that the overall health of the SMSF sector is sound.

The important role of accountants as gatekeepers has been recognised by the Government. Two key law reforms – the introduction of a new, limited Australian financial services (AFS) licence and the registration of SMSF auditors – highlight the trusted role accountants play in the SMSF sector.

We want to ensure that accountants and financial planners who are advising retail clients about SMSFs are providing good-quality advice. If we can

encourage gatekeepers to lift the standard of their advice, SMSF investors will really see the benefits.

New limited AFS licence

As you will all be aware, from 1 July 2013, accountants have been able to apply for and, if the application is approved, be granted a limited AFS licence. Recognised accountants¹ (which include members of the ICAA) who apply between 1 July 2013 and 30 June 2016 will be able to take advantage of transitional arrangements for entry into the AFS licensing regime. Under the transitional arrangements, different organisational competence requirements will apply where the responsible managers of the applicant are recognised accountants. Once the transitional period is over, all applicants will need to meet the full competence requirements under s912A(1)(e) of the *Corporations Act 2001* (Corporations Act).

Since 1 July 2013, we have received 19 applications and have issued two limited AFS licences. Of the 19 applicants, nine are members of the ICAA.

To help reduce the costs of operating within the AFS licensing regime, holders of a limited AFS licence can lodge a compliance certificate rather than undertake an annual external audit of their financial statements and internal controls. This exemption from the annual external audit requirement will be available to limited AFS licence holders who do not handle any client money in connection with the provision of financial advice.

It is important to note that, apart from the annual compliance certificate, holders of the limited AFS licence will need to meet the same ongoing requirements as other AFS licensees. This includes all other licensing conduct and advice requirements to which financial advisers are subject such as providing clients with a Statement of Advice (SOA), where required, as well as membership of an external dispute resolution scheme and compliance with the Future of Financial Advice (FOFA) measures, such as the best interests duty.

ASIC has provided guidance in Information Sheet 179 *Applying for a limited AFS licence* (INFO 179), available on our website. Our guidance provides an overview of the relevant steps in applying for a limited AFS licence, as well as explaining how existing ASIC guidance will apply.

Registration of SMSF auditors

As part of the Stronger Super reform initiatives, ASIC became the registration body for approved SMSF auditors from 31 January 2013. This

¹ 'Recognised accountants' refers to members of the Institute of Chartered Accountants in Australia, CPA Australia or the Institute of Public Accountants who comply with their membership professional education requirements: see reg 7.1.29A(2) of the Corporations Regulations.

reform recognises the key gatekeeper role that approved SMSF auditors play. The objective of SMSF auditor registration is to raise the standard of SMSF audit competency and ensure there are minimum standards across the sector.

To audit an SMSF you must be registered with ASIC as an approved SMSF auditor. It is an offence under the *Superannuation Industry (Supervisory) Act 1993* (SIS Act), for a person to hold themselves out as an approved SMSF auditor when they are in fact not an approved SMSF auditor.

ASIC released Regulatory Guide 243 *Registration of self-managed superannuation fund auditors* (RG 243) in January 2013 to provide further guidance to the industry regarding the registration requirements.

To be eligible for registration, you must have passed a competency exam within the 12-month period before you apply. Through our exam provider, Assessment Services Pty Ltd, ASIC has received approximately 330 exam bookings and delivered around 120 SMSF auditor competency exams, across 21 of the 44 exam venue locations. We are anticipating that over 1,800 exams will need to be delivered in this first year.

The required pass mark is 65% and so far about 75% of those sitting the exam have passed. Candidates are generally permitted two attempts at the exam, but very few second attempts have been taken. This may indicate that candidates are seeking further training before making their second attempt, to ensure they are up to the required standard.

Since the introduction of the SMSF auditor registration regime on 31 January 2013, as at 16 September 2013 ASIC has received 7,346 applications and we have registered and approved 7,035 SMSF auditors.

With the establishment of a public register, for the first time SMSF trustees are able to identify suitably qualified auditors to conduct an SMSF audit.

We also hope that, among those using the register, there are accountants who either verify that the auditors they are referring to SMSFs are registered with ASIC to conduct SMSF audits, or are looking to prove to others that they are in fact registered to conduct audits. Our records show that as at 16 September 2013, 69,535 SMSF auditor searches have been conducted on ASIC Connect.

Being able to identify approved SMSF auditors is one of the key objectives of the regime. We hope accountants find the search function helpful. Having a publicly available register should promote a level of confidence that the sector meets minimum standards, and it enables ASIC to get updates to auditors quickly and easily if the need arises.

ASIC's focus on SMSFs and our review of advice

Let me now turn to our work through the ASIC SMSF taskforce.

ASIC established this taskforce in September 2012. We were concerned by several developments, including an increase in geared investment strategies and increasingly aggressive advertising for SMSFs.

As well as focusing on specific issues that concerned us, we wanted to work more broadly on encouraging advisers to SMSFs to lift the quality of advice because better advice ultimately means better outcomes for SMSF investors.

The purpose of the taskforce is to examine high-risk SMSF issues. As its first major project, the taskforce looked at the quality of advice provided to SMSF investors, with ASIC's overarching aims in this area being to ensure that:

- only those investors for whom an SMSF is suitable are advised to establish an SMSF
- SMSF investors receive good-quality advice and services in relation to SMSFs from gatekeepers.

On 18 April 2013, we released Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337), which sets out the results of our 2012 review into the quality of advice provided by financial planners and accountants to some lower-balance SMSFs (i.e. funds with a balance of \$150,000 or less).

It is important to note that we deliberately targeted files that looked more likely to be higher risk for SMSF members.

While REP 337 found that the majority of advice provided to SMSF clients as part of our file review was of an adequate quality, the report did highlight concerning pockets of poor advice. Much of this advice involved recommendations that investors set up an SMSF to gear into real property.

Through our file reviews, we found that there is room for significant improvement in aspects of the SMSF advice giving process. Where we found problems with the advice it tended to be in the following areas:

- the advice was not sufficiently tailored
- replacement product disclosure was absent or inadequate
- insurance recommendations were absent or inadequate
- an inappropriate single asset class was provided to investors
- suitable alternatives to an SMSF were not considered
- there was inadequate consideration of the investor's long-term retirement planning objectives.

Notably, we also found that investors were not warned about the very real risk of not having access to a statutory compensation scheme in the event of theft or fraud.

We provided feedback to all entities involved in the review and we have seen a number changes to templates, compliance arrangements and overall business practices.

To improve the quality of advice provided to clients, REP 337 identifies some practical tips for giving advice to clients on SMSFs. These practical tips have been developed based on the problems we identified as part of our file reviews.

Consultation paper on additional disclosure and costs

As part of the next stage of taskforce work, yesterday we released Consultation Paper 216 *Advice on self-managed superannuation funds: Specific disclosure requirements and SMSF costs* (CP 216). The consultation paper covers two broad issues and proposes to:

- implement specific disclosure requirements to improve the quality of advice given to investors who are considering setting up or switching to an SMSF
- examine the costs associated with setting up, running and winding up an SMSF, and to develop guidance to improve the quality of advice about SMSFs.

Disclosure requirements

We are proposing to modify the law, by way of class order, to impose specific disclosure requirements on AFS licensees and their authorised representatives who give personal advice to clients on establishing or switching to an SMSF. These include:

- the duties and obligations associated with running an SMSF, including that trustees remain responsible for managing the fund even if they outsource some or all of their responsibilities
- the risks associated with running an SMSF
- the need to develop and implement an appropriate investment strategy for an SMSF
- the time commitment and skills needed to run an SMSF effectively
- the costs associated with setting up, running and winding up an SMSF
- the need to consider and develop an exit strategy for an SMSF
- the possibility that the laws and policies that affect SMSFs may change.

We propose to require AFS licensees and their authorised representatives to provide these disclosures to clients:

- where an SOA is the means by which the advice is given – in the SOA itself
- where an SOA is not the means by which the advice is given – at the time the advice is provided, and in the SOA when it is later given to clients.

The proposals build on the key findings of our review of advice and should be considered in conjunction with the practical tips that we have set out in REP 337.

We propose that AFS licensees and their authorised representatives should be required to make these disclosures to clients six months after the class order is made.

Rice Warner's research and our proposed guidance on SMSF costs

I now turn to the second broad issue and our proposed guidance on SMSF costs.

Whether there should be a minimum fund balance size for SMSFs has long been an issue of debate. Many industry participants question whether an SMSF with assets of less than \$200,000 can be cost-effective when compared with an APRA-regulated fund.

Within industry, there is also a lack of consensus on the costs associated with setting up, running and eventually winding up an SMSF. In our view, it is important to consider costs when making a recommendation to establish or switch to an SMSF.

In late 2012, ASIC commissioned Rice Warner Actuaries to examine the minimum cost-effective balance for SMSFs compared with APRA-regulated superannuation funds. We have decided to publish the Rice Warner report as an attachment to CP 216 and seek feedback on Rice Warner's findings. The purpose of this is to encourage further debate and explore the issues relating to SMSF costs.

Rice Warner's research found that there was a range of costs that reflected the range of complexity of the SMSFs themselves. Rice Warner found that:

- SMSF fund balances with less than \$100,000 are not competitive in comparison to APRA-regulated funds. SMSFs of this size would only be appropriate if they are expected to grow to a competitive size within a reasonable time
- SMSF fund balances of \$100,000 to \$200,000 can be competitive with more expensive APRA-regulated funds if the trustees undertake the

broader investment and administration functions. For example, SMSFs of this size may be competitive with more expensive APRA-regulated funds if the trustees outsource transactional services, but undertake other investment and administration functions themselves

- SMSF fund balances of \$200,000 to \$500,000 can provide equivalent value with APRA-regulated funds provided the trustees undertake some of the administration
- SMSF fund balances of \$500,000 or more can provide equivalent value to APRA-regulated funds on a full service basis.

To be clear, ASIC is not proposing a mandated minimum balance, but rather is looking to provide clearer guidance on this issue based on research and on industry and investor views.

In addition, we propose to hold some round-table discussions with industry and investor representatives to further explore the issue of SMSF costs.

We propose to give guidance, informed by Rice Warner's work and the feedback we receive from stakeholders on the report, to improve the quality of advice which recommends that a client establish or switch to an SMSF.

We understand industry is busy coming to grips with a number of regulatory changes so we have provided an eight week consultation period.

We look forward to working with industry in the coming months to continue to improve SMSF advice.

Conclusion

As I said before, ASIC is focused on encouraging gatekeepers to lift the standard of their advice and we expect SMSF investors to really see the benefits.

I suggest that if accountants haven't already, you start thinking about preparing to enter the licensing regime and understanding the conduct and advice requirements that will apply to limited AFS licensees.

I hope that today I've given you a sense of some of the work ASIC is doing in the SMSF sector and the important gatekeeper role your industry plays in helping us ensure that the SMSF sector remains vibrant, healthy and safe for investors.